

Fundamental Stakeholder Demands in Listed Companies



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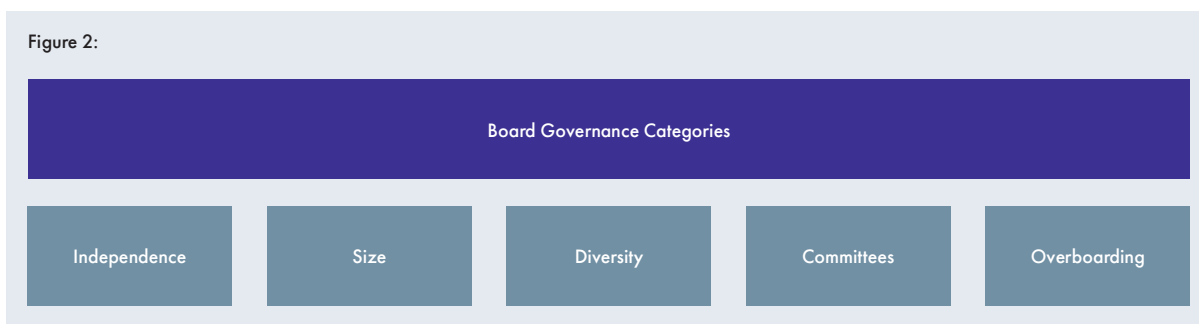
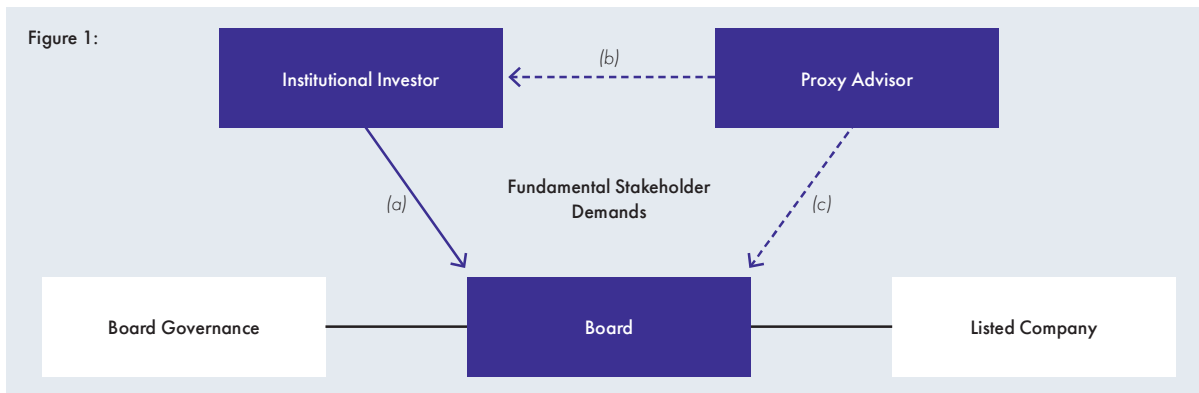
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1. Introduction

The design practice of board organization – so-called «board governance» – is constrained by both a regulatory environment and the demands of various stakeholders. The regulatory environment in the form of legislative articles, directives, and guidelines provides a framework for board governance. Fundamental stakeholders – which in this article refers to both institutional investors and proxy advisors – make further demands regarding a company’s board governance by exercising their voting rights or making recommendations on the exercise of voting rights, respectively.

If the fundamental stakeholders are to be defined, the following setup is applied (graphic 1). In the bottom center a listed company and its board of directors is shown. Institutional investors actively influence a company’s board governance by exercising their voting rights (a). Proxy advisors, on the other hand, do not hold any voting rights. Still, they advise institutional investors on how to exercise their voting rights (b). So, indirectly they also have an influence on a listed company’s board governance (c). The overall resulting impact is summarized as fundamental stakeholder demands. The magnitude of this impact is analyzed using five board governance categories, which were derived from the Business Roundtable’s Principles of corporate governance: Independence, size, diversity, committees, and overboarding (graphic 2).¹ These are frequently emphasized in the context of board governance. However, this selection should not be regarded as conclusive. Holistically seen, there are further board governance categories such as succession planning and board operations.

¹ Business Roundtable. (2016). Principles of Corporate Governance. Harvard Law School Forum on Corporate Governance, heading III.



2. Change in shareholder structures leading to power shuffle

The composition of the shareholder base of listed companies in Switzerland has changed significantly in recent decades. The proportion of shares in listed companies that are held and professionally managed in various collective funds – together called «institutional investors» – was around 60% in 2007. Today, it often exceeds 70% in large publicly traded companies.² Depending on their size, these institutional investors may hold thousands of different shares and thus have the rights to vote on tens of thousands of agenda items at AGMs.³

This situation requires vast research to provide the necessary basis for decision-making and implies an infrastructure that can cope with electronic voting at such high volumes, particularly because most of these votes are concentrated

in a few months of the year.^{4,5} Both research and infrastructure services are offered by so-called proxy advisors. These advisors are not shareholders themselves. Rather, they advise others on how to vote and then cast the vote on behalf of the institutional investor.

Hence, proxy advisors give their opinions on behalf of a large number of institutional investors, who in turn have considerable voting power. The opinions of proxy advisors thus affect the voting behavior of institutional investors, although the significance of their influence is difficult to measure.⁶ Many researchers agree that their influence is increasing.⁷

2 Böckli, P. (2015). Proxy Advisors: Risikolose Stimmenmacht mit Checklisten. Schweizerische Zeitschrift Für Wirtschafts- und Finanzmarktrecht, 209–224.

3 Faery, R., Sharma, C., Franco, M., & Thrasher, C. (2022). The Investor Landscape.

4 Gustinetti Henz, T. (2016). Die Rolle und Rechtsstellung von Stimmrechtsberatungsunternehmen (Proxy Advisor) im schweizerischen Recht unter besonderer Berücksichtigung der Regulierungsfrage.

5 Rose, P. (2021). Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting. Harvard Law School Forum Corporate Governance, para. 7.

6 Spatt, C. (2019). Proxy Advisory Firms, Governance, Failure, and Regulation. Harvard Law School Forum on Corporate Governance, para. 5.

7 Edelman, S. (2013). Proxy Advisory Firms: A Guide for Regulatory Reform. Emory Law Journal, 62(3), 1369–1409.

3. Voting guidelines as behavioral directives, further contextualized by expert opinions

Fundamental stakeholders base their proxy voting and voting recommendations, respectively, on voting guidelines.⁸ While institutional investors can tailor their voting guidelines to their own needs, proxy advisors' guidelines tend to be more comprehensive and detailed due to their provision of voting recommendations for multiple institutional investors.

In terms of voting guidelines, a sample of four institutional investors (BlackRock, Vanguard, UBS Asset Management, and Norges Bank Investment Management) and four proxy advisors (ISS, Glass Lewis, Ethos, and Inrate) have been considered for analysis. The former were chosen based on their number of shares held in SMI companies and only if they published their voting guidelines. The latter were selected as these proxy advisors cover the Swiss market almost entirely.

Besides the voting guidelines, four fundamental stakeholder representatives and a representative of a corporate governance think tank were interviewed. Experts were selected based on their leadership positions in the investment stewardship team among institutional investors and the corporate governance team among proxy advisors. The idea behind this was to contextualize identified similarities and differences with the help of experts after analyzing the voting guidelines. The corporate governance think tank expert was brought in to provide a third-party perspective to the analysis.

4. What the analysis of voting guidelines and expert opinions revealed

As already introduced, the extent of the fundamental stakeholders' demands was examined on the basis of five board governance categories. The results of this examination are subsequently revealed by category.

8 Diem, H.-J., & Gaberthüel, T. (2022). The Corporate Governance Review: Switzerland. The Law Reviews, para. 4.

4.1. Independence

The majority of stakeholders agree that the board should be independent, with at least a third of board members expected to be independent in the case of a controlled, listed company. Various criteria are used to assess board members' independence, including the use of two- or three-class systems, with stakeholder-specific definitions of the classes. The voting rights threshold for determining independence classification varies significantly. BlackRock applies a 20% threshold. The other institutional investors do not comment specifically. ISS and Glass Lewis apply 10%. The analyzed data suggests that institutional investors seek more flexibility in assessing director independence, while proxy advisors prioritize transparency in ownership rights by relying on the SIX Swiss Exchange threshold.

4.2. Size

None of the stakeholders prescribe an exact board size, but four suggest approximate ranges, with a minimum of five board members and a maximum of 20. The size of the board seems to depend on the size of the company, with Swiss proxy advisors Ethos and Inrate applying different ranges for small-cap, mid-cap, and large-cap companies. The institutional investors interviewed do not specify an ideal board size but note that unusually small or large boards may require company engagement. Inrate imposes a limit on the number of board members depending on the company size, while Ethos does not have a firm opinion but acknowledges potential drawbacks of both small and large boards. The Swiss corporate law requires at least one natural person on the board, but the size of the board is left to the company's discretion. Overall, fundamental stakeholders are not prescriptive in terms of a specific board size. If anything, the adequate number of board members is demanded as a function of the company size.

4.3. Diversity

The importance of a diverse board was recognized by the fundamental stakeholders, who recommended regular reviews of the board to maintain diversity of skills and experience, and disclosing the results. A gender quota of 30% representation was demanded by most stakeholders, with some exceptions that tolerated partial compliance provided a commitment to narrow the gap was made within a year.

UBS Asset Management demands 40% gender representation by 2025. The regulatory environment in Switzerland lags behind its European neighbors, with gender representation introduced in Swiss corporate law on a «comply or explain» basis from 2026. The Swiss Code only recommends both genders be represented with appropriate diversity. One stakeholder expressed concern that the gender requirement at board level may lead to a shortage of women at management level.

4.4. Committees

The demands of fundamental stakeholders regarding committees are mainly focused on the independence and objectivity of key committees, while few demands were observed regarding the organization and number of committees, which is mostly left to the companies themselves. Institutional investors and proxy advisors did not impose specific committees beyond the key ones and do not want to micromanage companies. The regulatory environment imposes certain demands on committees, such as the requirement for the compensation committee to be elected by the AGM and for the audit and compensation committees to be composed of non-executive, independent members. The Swiss Code also sets requirements for the nomination committee to be composed of a majority of non-executive, independent members. There seems to be no one-fits-all solution in this regard. The analysis showed that the vast majority of fundamental stakeholders leave the organization of companies to themselves.

4.5. Overboarding

Most fundamental stakeholders recommend a maximum of five non-executive mandates for board members in listed companies, with some allowing for one or two additional mandates depending on the role of the member. Weighting systems for mandates vary, with a non-executive chairperson mandate usually being weighted at least double that of other mandates, and executive roles being equated to three mandates. The experts consulted believe that tolerated mandates are likely to decrease in the future, especially for executive functions. The regulatory environment allows companies to specify the maximum number of mandates in their articles of association, and the Swiss Code does not impose explicit requirements regarding mandates.

5. Conclusion

The examination of both voting guidelines and expert opinions has revealed a considerable divergence in the core demands expressed by fundamental stakeholders across the various categories of board governance investigated. This disparity is contingent upon the nature of the stakeholder in question, as well as the unique characteristics and preferences exhibited by each individual stakeholder.

Unsurprisingly, yet remarkably, institutional investors demonstrate notably less explicit and comprehensive demands concerning board governance in comparison to proxy advisors. During expert interviews, representatives of institutional investors underscored their preference for engaging in dialogue to cultivate the requisite comprehension necessary for determining company-specific voting behavior. On the surface, this approach appears commendable; however, doubts arise regarding whether institutional investors possess the requisite resources to execute such an undertaking. It is prudent for a company to anticipate sensitive agenda items for annual general meetings and proactively address them with fundamental stakeholders at the earliest possible juncture. This proactive approach ensures that the unique circumstances of the individual company are duly considered in the decision-making process regarding the exercise of voting rights. Failure to do so runs the risk of voting rights being exercised solely based on prescribed voting guidelines, thereby undermining the nuanced assessment of each company's situation.